Contract Types

Session 2

Cost Reimbursement

R. E. Jones

Background

Contract Type Sessions

Concepts

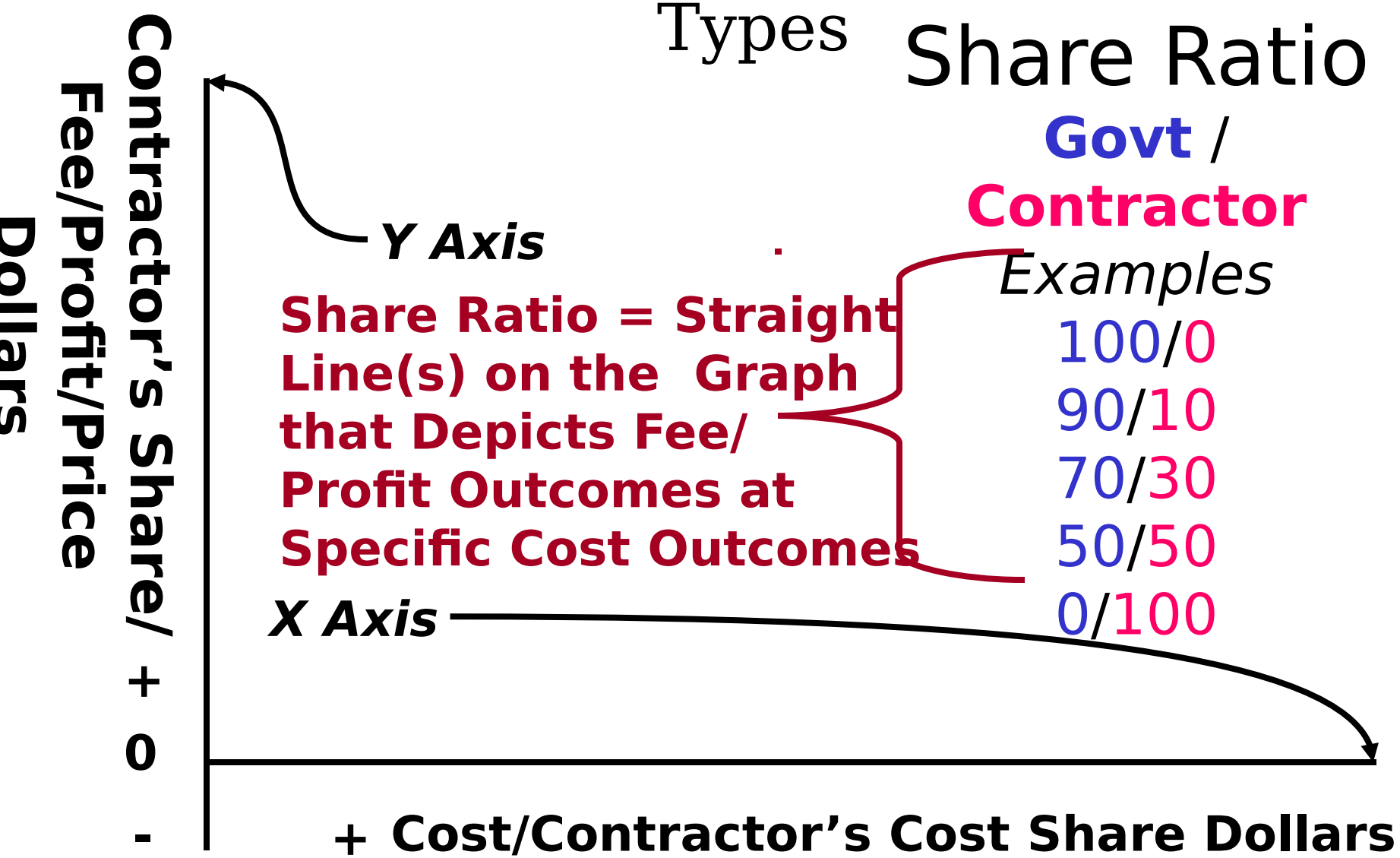
Cost Reimbursement

Fixed Price

Miscellaneous Types & Incentives

Cartesian Quadrant(s)

Graphical Approach to Contract Types



Cost Reimbursement

Cost Reimbursement General Concepts

Contracts that provide for payment of **allowable incurred cost** to the extent prescribed in the contract,

and establish an estimate of total cost for the purpose of obligating funds and establishing a ceiling

that the contractor may not exceed (except at its

ov

(Graphs that follow will not show ceilings EXCEPT for Letter contracts)

Cost Reimbursement General Concepts

- Application & Limitations
  - Uncertainties involved in contract performance make estimating cost with sufficient accuracy for any fixed price contract impossible.
    - R&D, Concept Development, Prototype, etc
  - **Not** for acquisition of commercial items
  - ***Contractor must have approved accounting system***
    - Contractor provides cost data/earned value analysis
  - ***Government must exercise surveillance of contractor***

Cost Reimbursement General Concepts

- Ceiling
  - Imposed by Limitation of Cost (fully funded) & Limitation of Funds (incrementally funded)
    - Contractor's obligation to notify PCO prior to funds run-out date
    - **PCO must act to fund or not**
    - If no additional funds are provided, contractor can stop work or continue at its own risk
      - PCO can over-ride contract by conduct or words

Letter Contracts
FAR 16.603

- A letter contract is a written preliminary contractual instrument
  that authorizes the contractor to begin immediately

- Application
  - The Government's interests demand that the contractor be given a binding
    commitment so that work can start immediately and
  - Negotiating a definitive contract is not possible in

- Letter contracts:
  - Shall be definitized at earliest possible date
    - Within 180 days of issuance or when 40% of work performed
  - Shall not exceed 50 percent of the estimated cost of the definitive contract
    unless approved in advance by the authorizing official

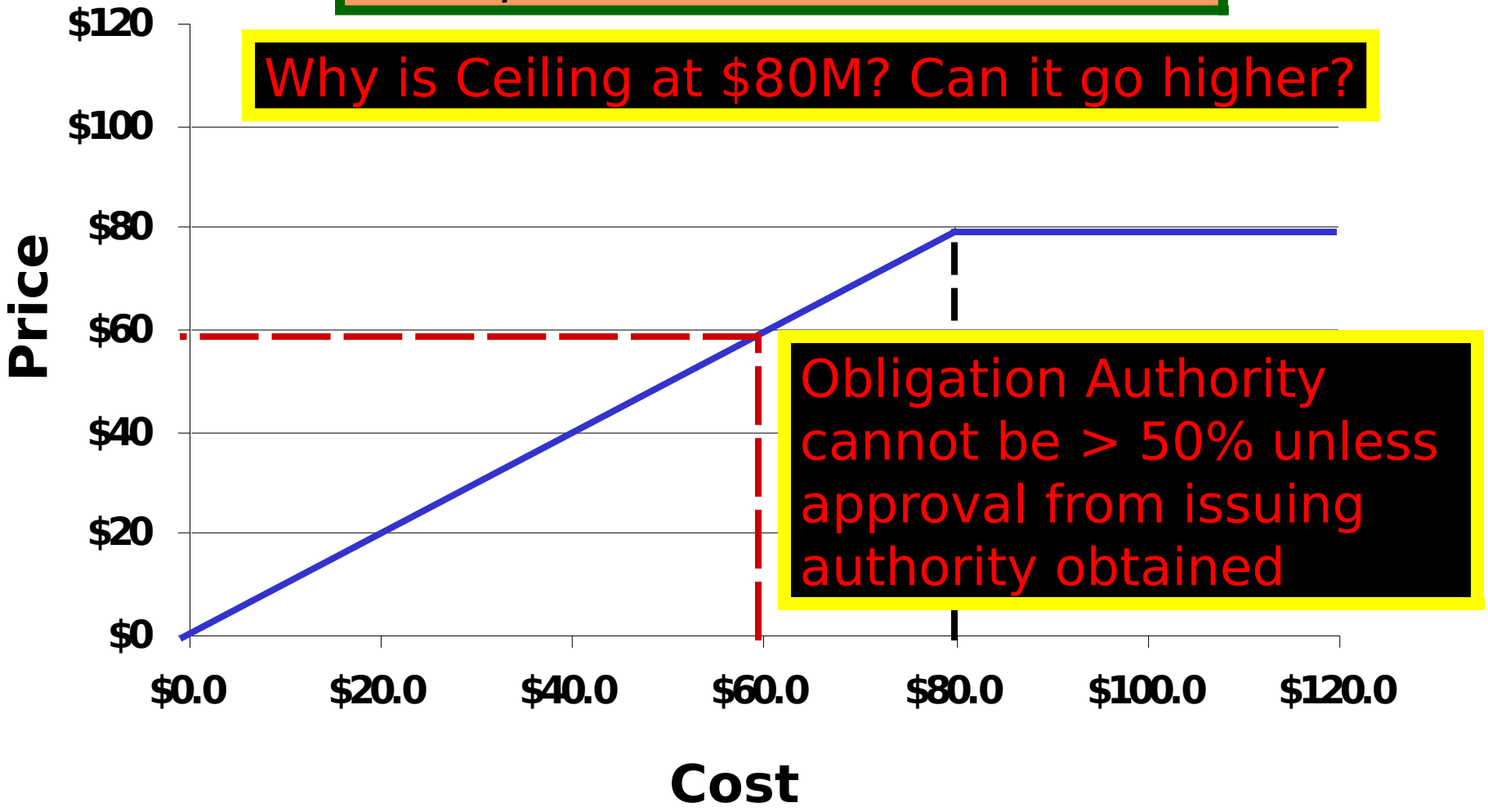
Letter Contracts
FAR 16.603

- Limitations
  - May be used only after the head of the contracting activity or determines in writing that no other contract is suitable.
  - Letter contracts shall not
    - Commit the Government to a definitive contract in excess available at the time the contract is executed;
    - Be entered into without competition when competition is r Part 6; or
    - Be amended to satisfy a new requirement
      - Unless that requirement is inseparable from the existing lette
      - Any such amendment is subject to the same requirements an limitations as a new letter contract

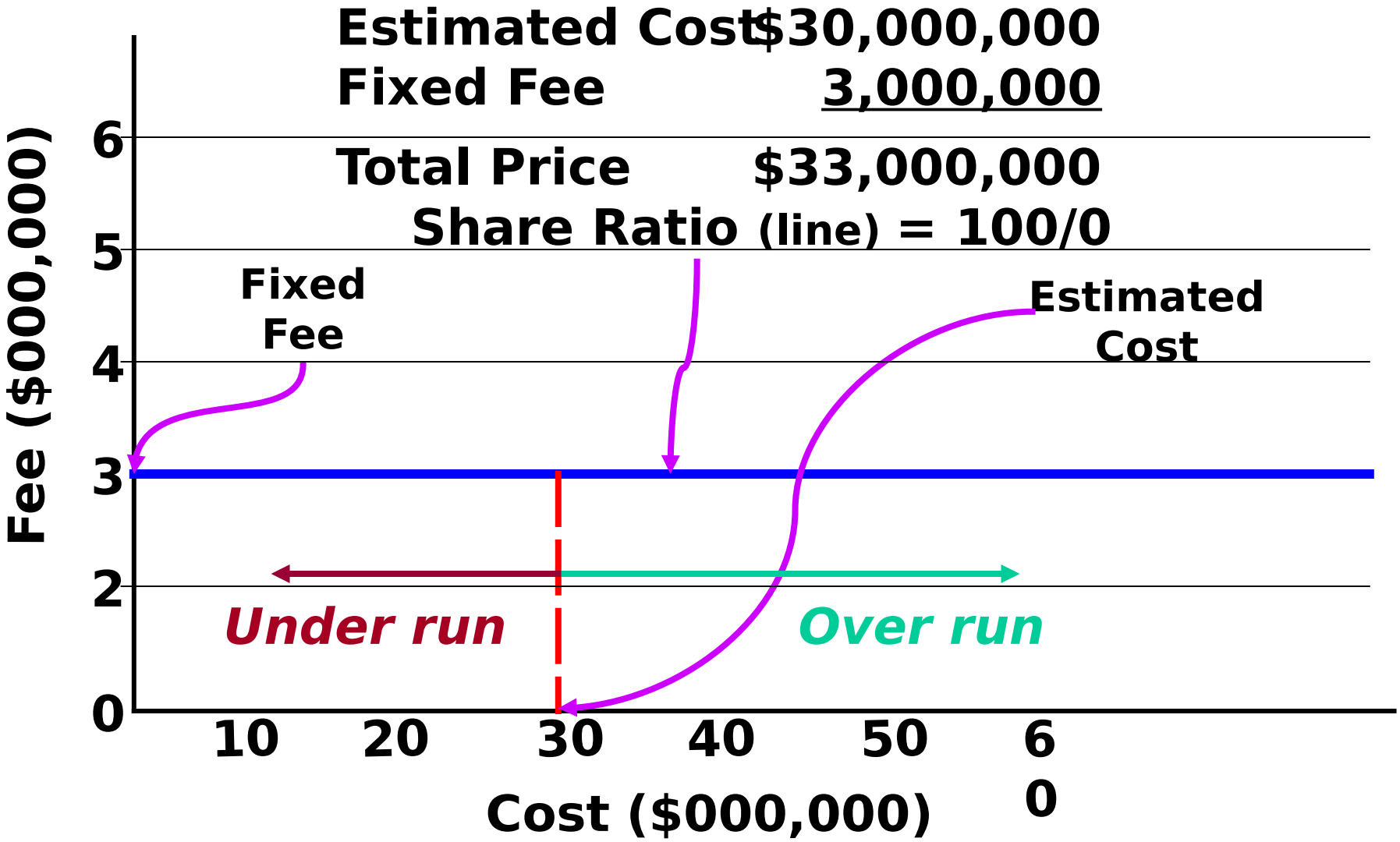
Letter Contract

$ Millions

Example: $160M Letter Contract



Cost Plus Fixed Fee



Cost Plus Fixed Fee

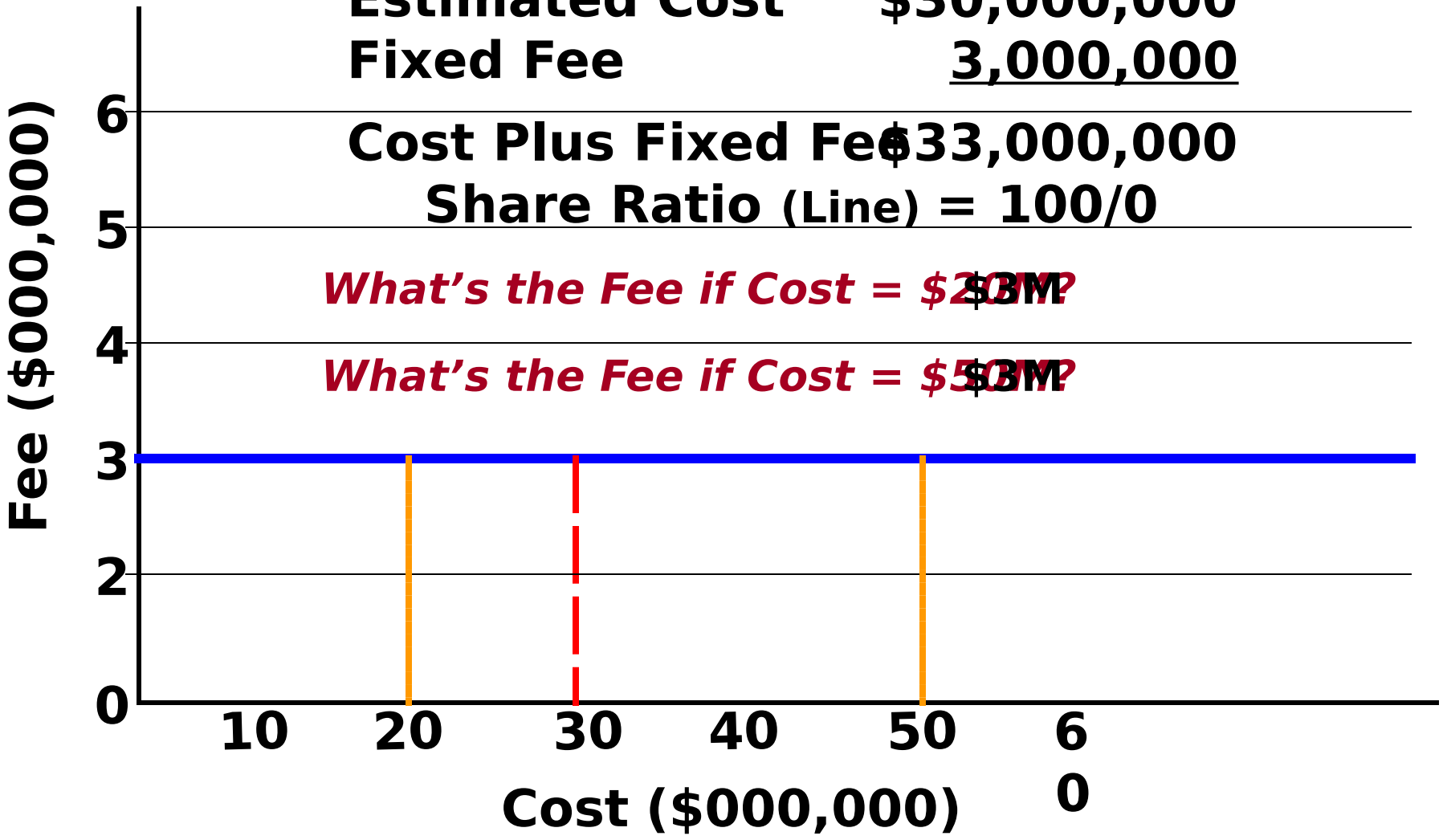
Estimated Cost **$30,000,000**
Fixed Fee **3,000,000**

Cost Plus Fixed Fee **$33,000,000**

Share Ratio (Line) = 100/0

What's the Fee if Cost = $20M? **$3M**

What's the Fee if Cost = $50M? **$3M**



Cost Plus Fixed Fee Level-of-Effort (10,000 hours)

Estimated Cost	$1.050M	
Fixed Fee	0.084M	(8.0%)
Total CPFF	$1.134M	

If the Contractor incurs $0.95M
And delivers 10,000 hours
How much fee was earned

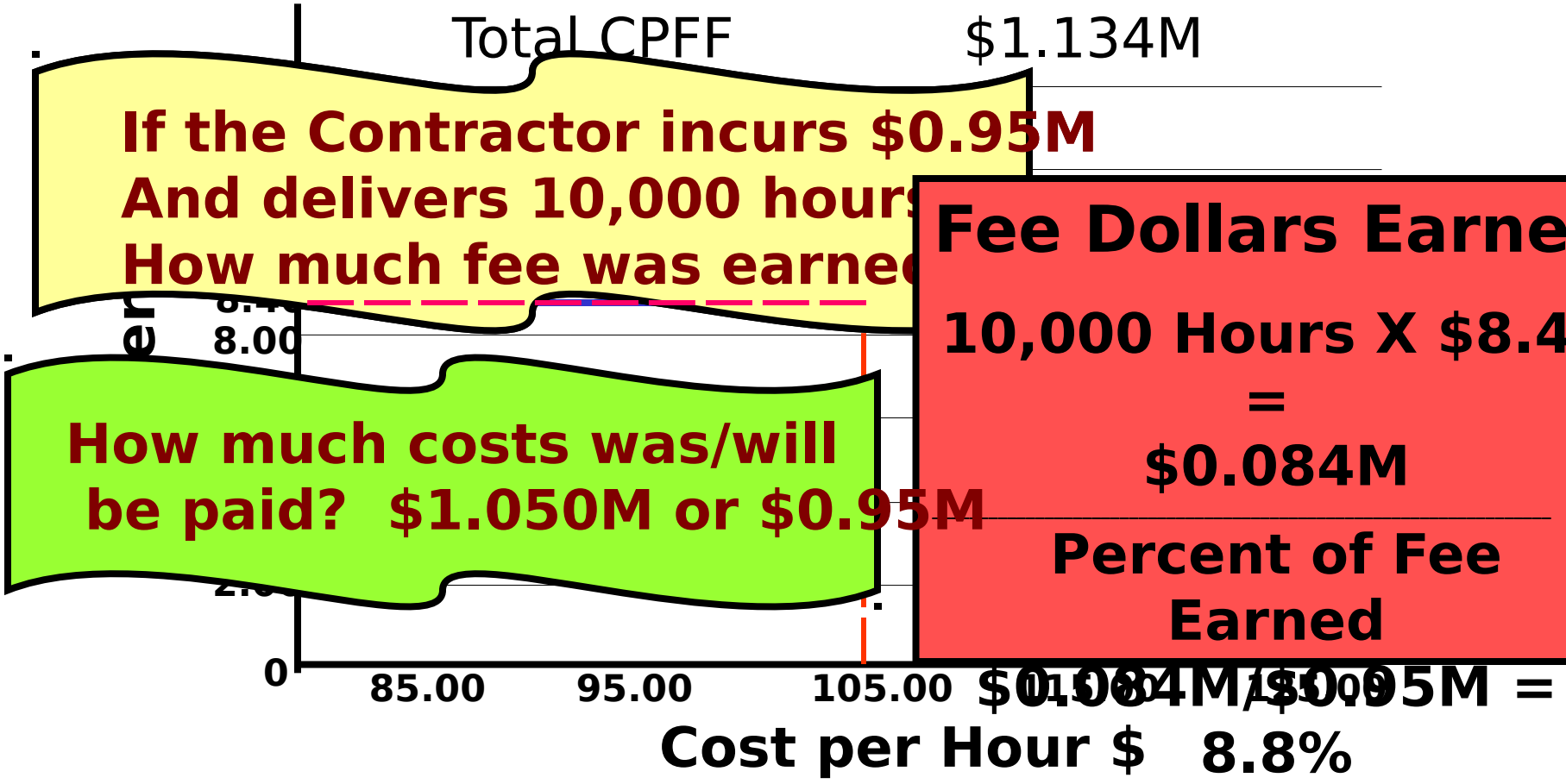
How much costs was/will be paid? $1.050M or $0.95M

Fee Dollars Earned

10,000 Hours X $8.40
=
$0.084M

Percent of Fee Earned

$0.084M / $0.95M = 8.8%



Cost Plus Fixed Fee
Fee Limitations *

The PCO shall not negotiate a fee that exceeds statutory limitations of:

15% of estimated costs for Experimental, Developmental, or R&D effort

6% of estimated costs for A&E work

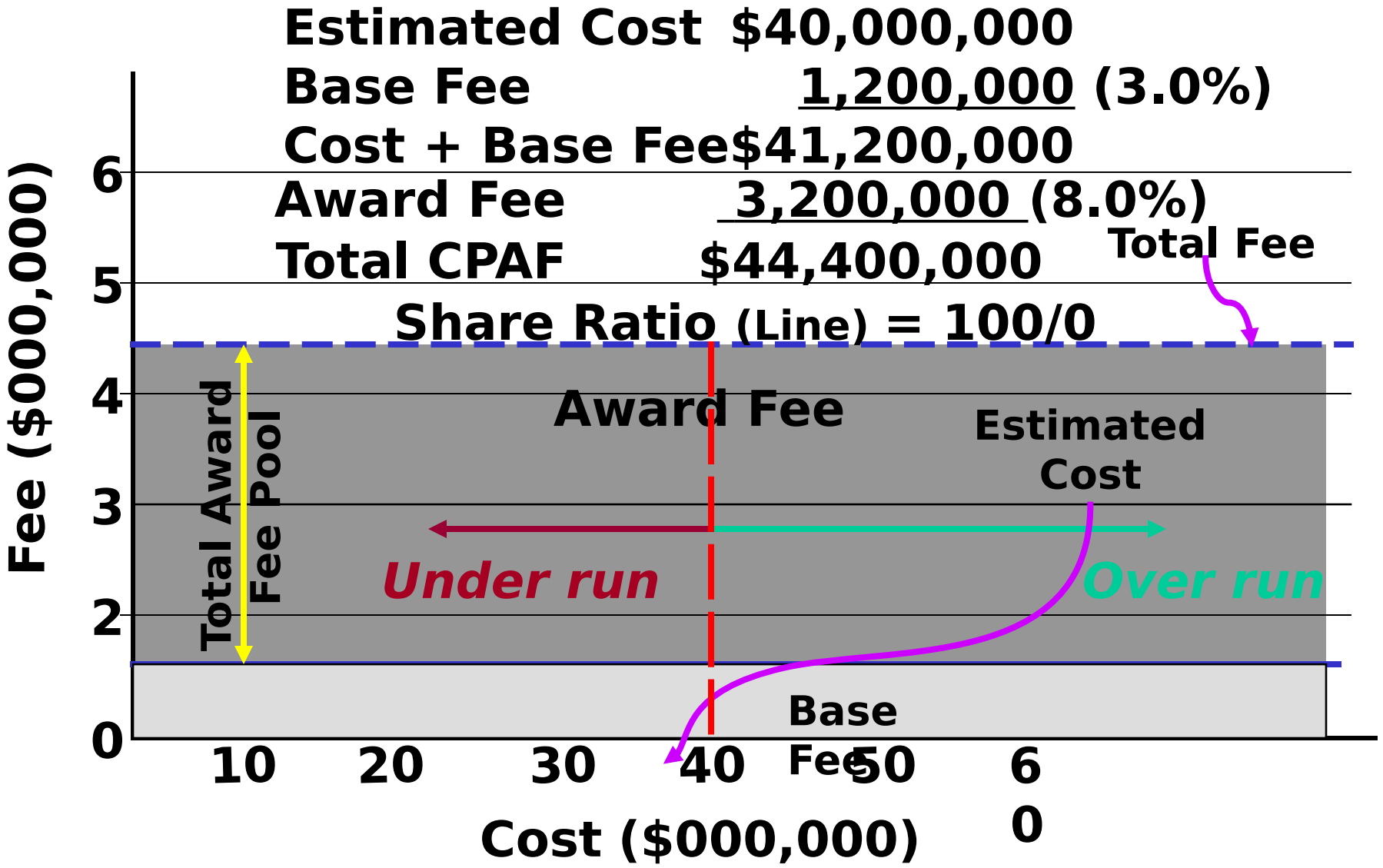
10% of estimated costs for all other efforts

*** See FAR 15.404-4(c)(4) for statutory citations**

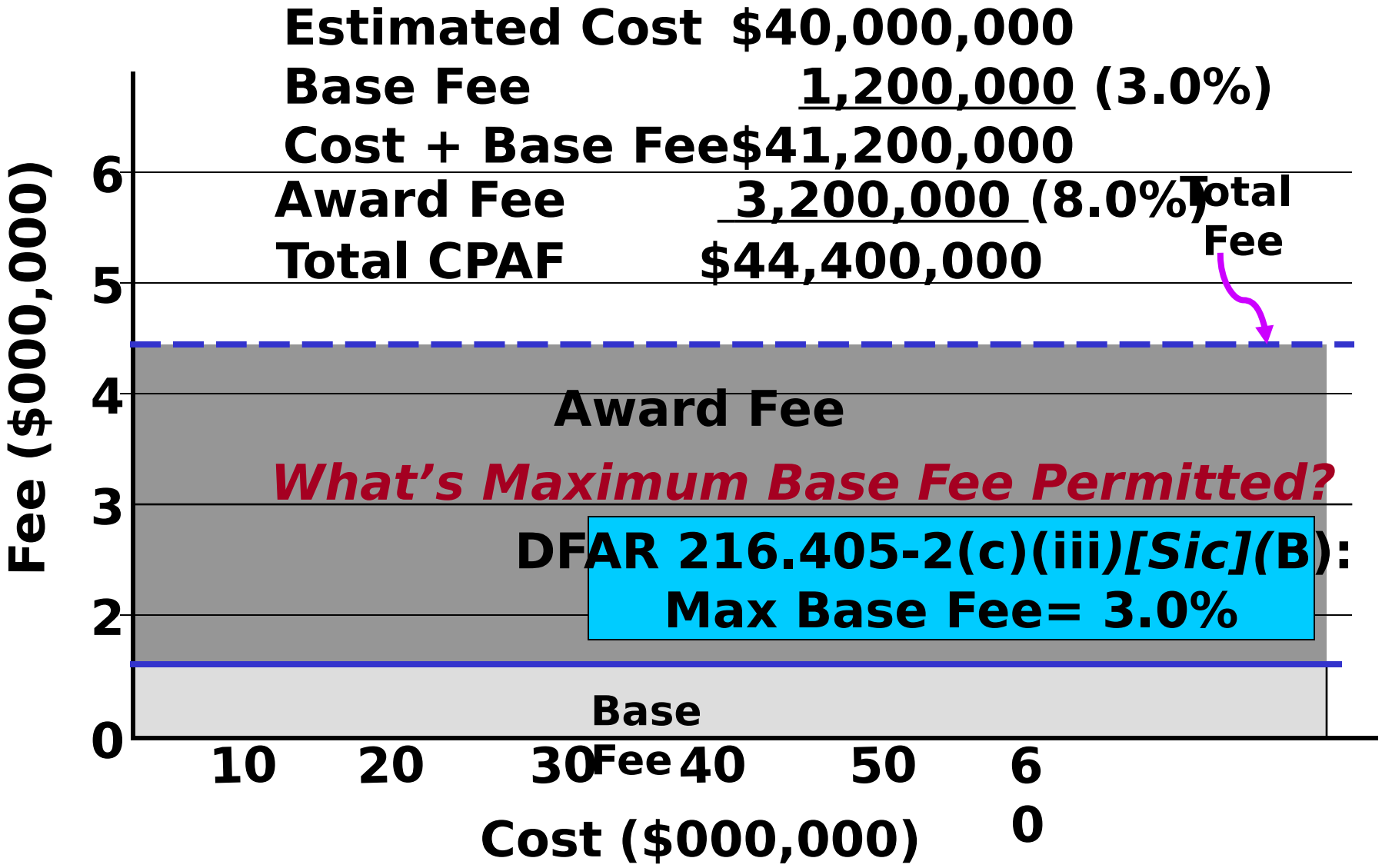
Award Fee

- May be used on either Cost (except CPFF) or Fixed Price Contract Type
  - Shown here because CPAF is distinct type
- Pool of dollars negotiated and spread over a period of performance
  - Separate Award Fee periods established
- Award Fee Plan included in negotiated contract
  - Baseline for evaluating contractor's performance
- Award Fee Review Board are function/technical experts
  - Provides Fee Determining Official (FDO) with award fee recommendation
- FDO determines actual award
  - Subjective, Unilateral, Not subject to "Disputes" clause
- Labor intensive to administer
- See SMC/PK *Provisional Award Fee Payments* Ltr 13 Feb 04

Cost Plus Award Fee

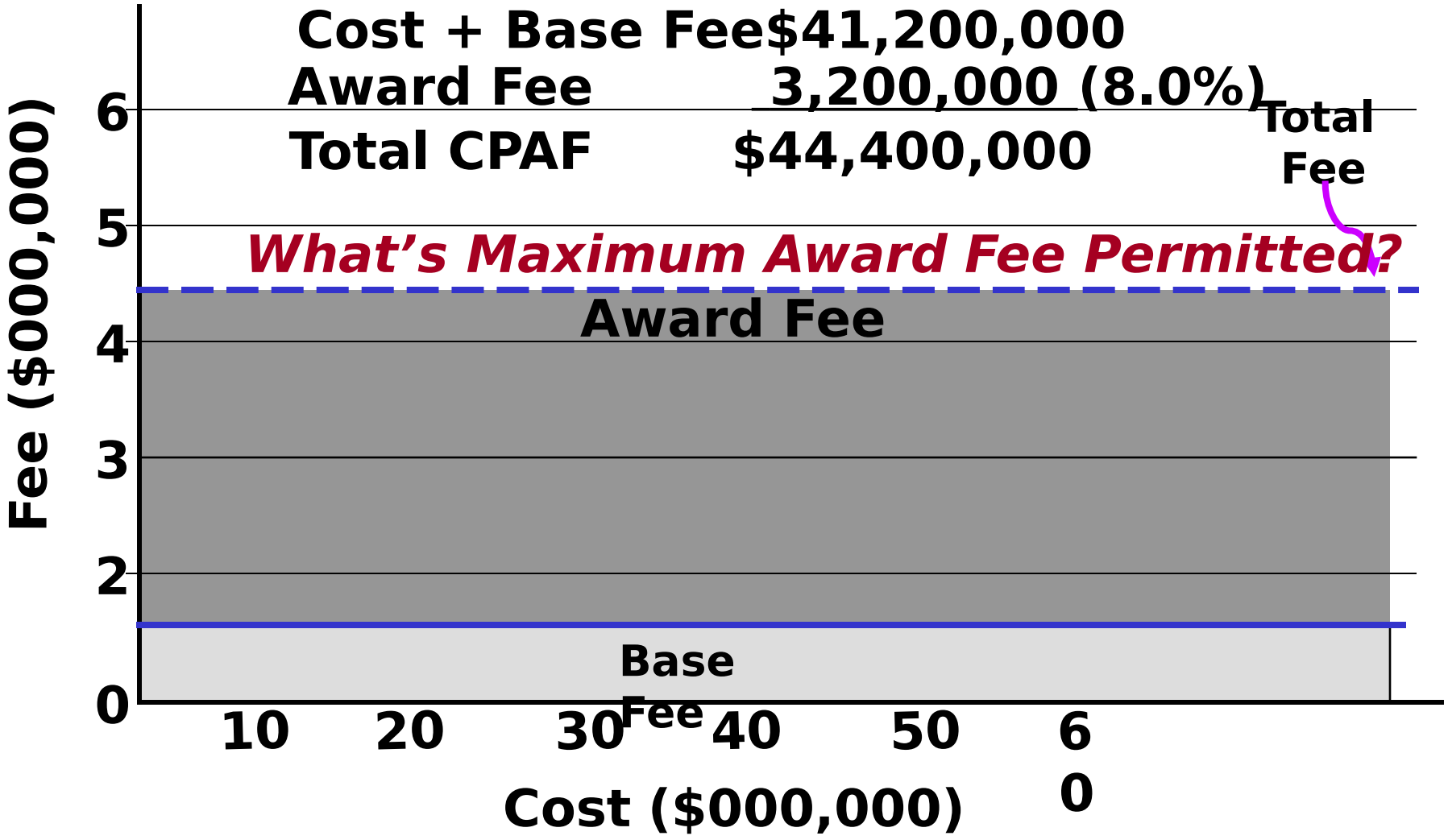


Cost Plus Award Fee



Cost Plus Award Fee

Estimated Cost	$40,000,000
Base Fee	1,200,000 (3.0%)
Cost + Base Fee	$41,200,000
Award Fee	3,200,000 (8.0%)
Total CPAF	$44,400,000



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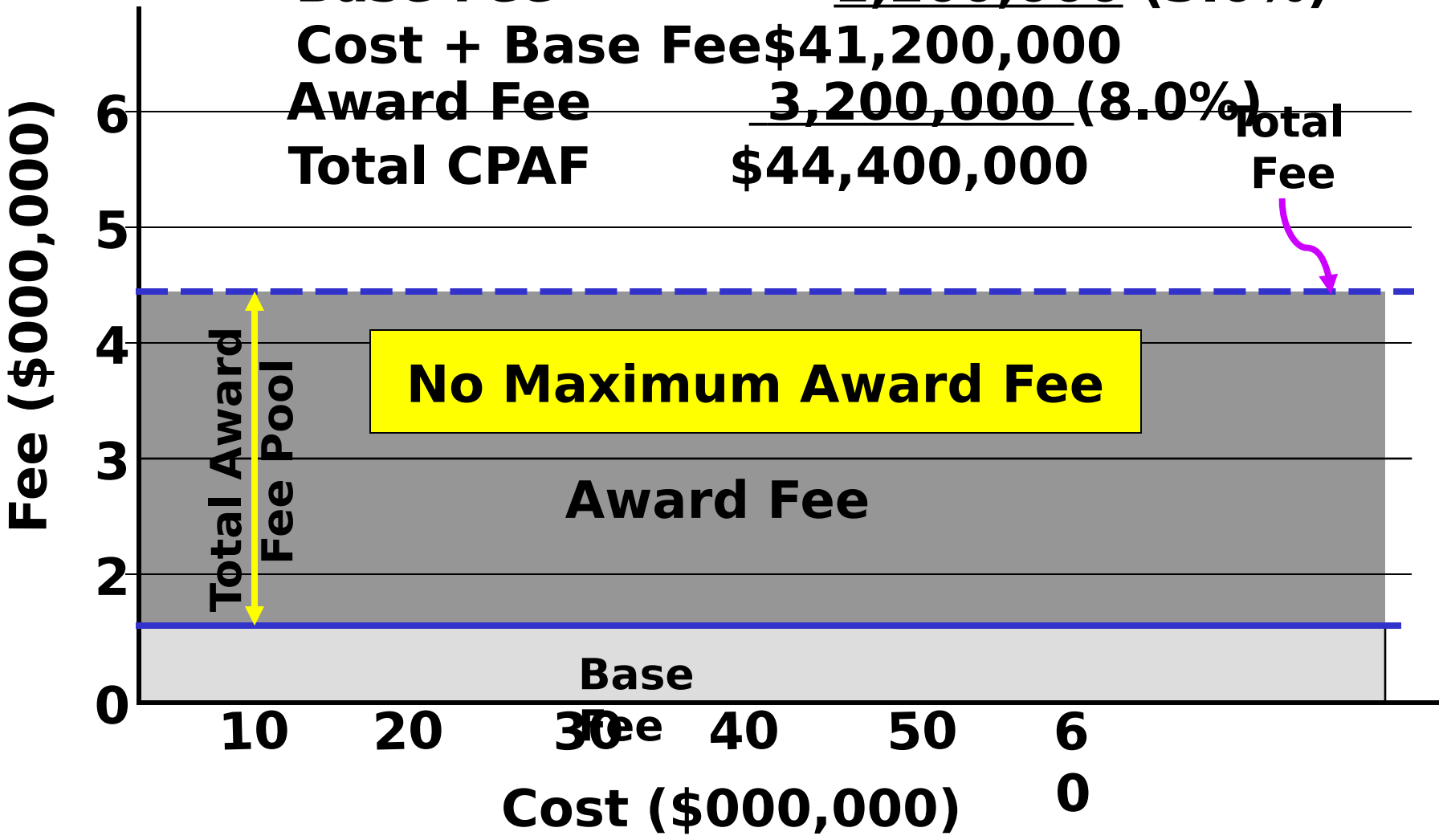
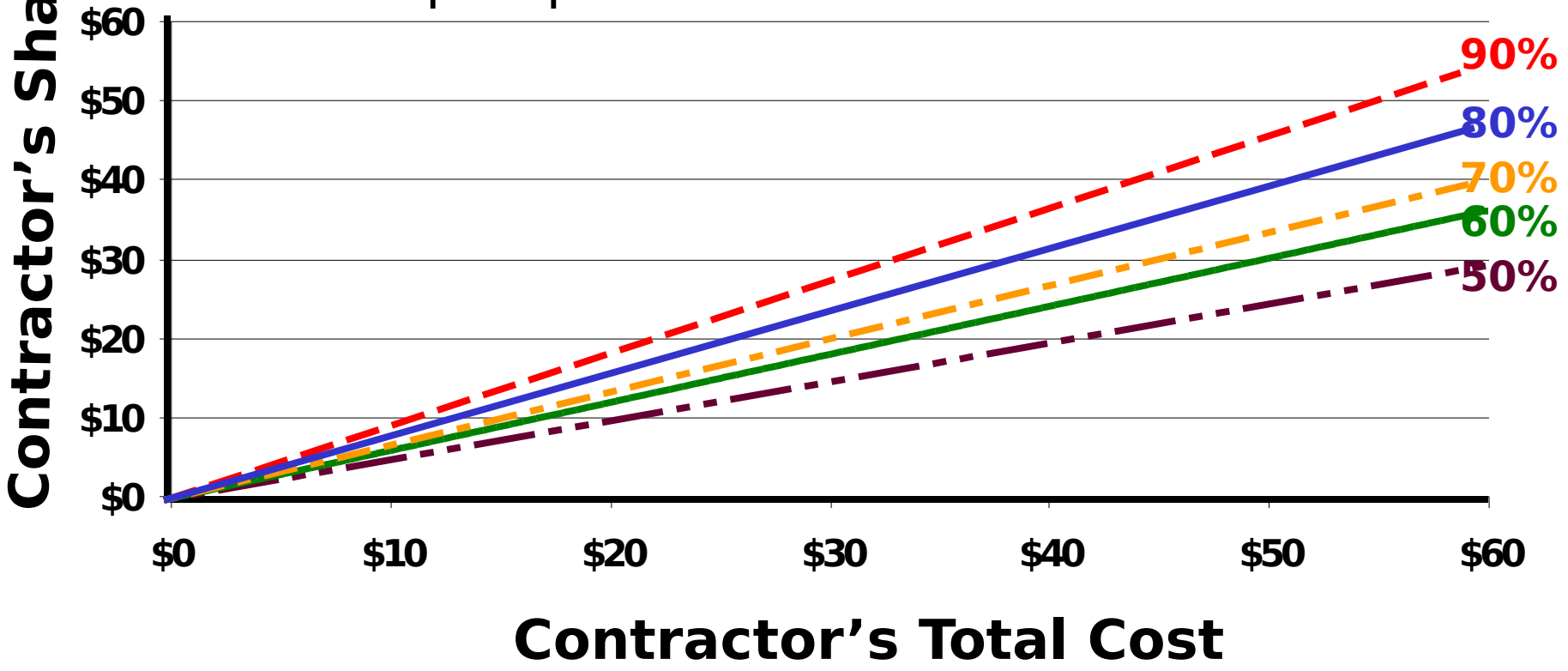


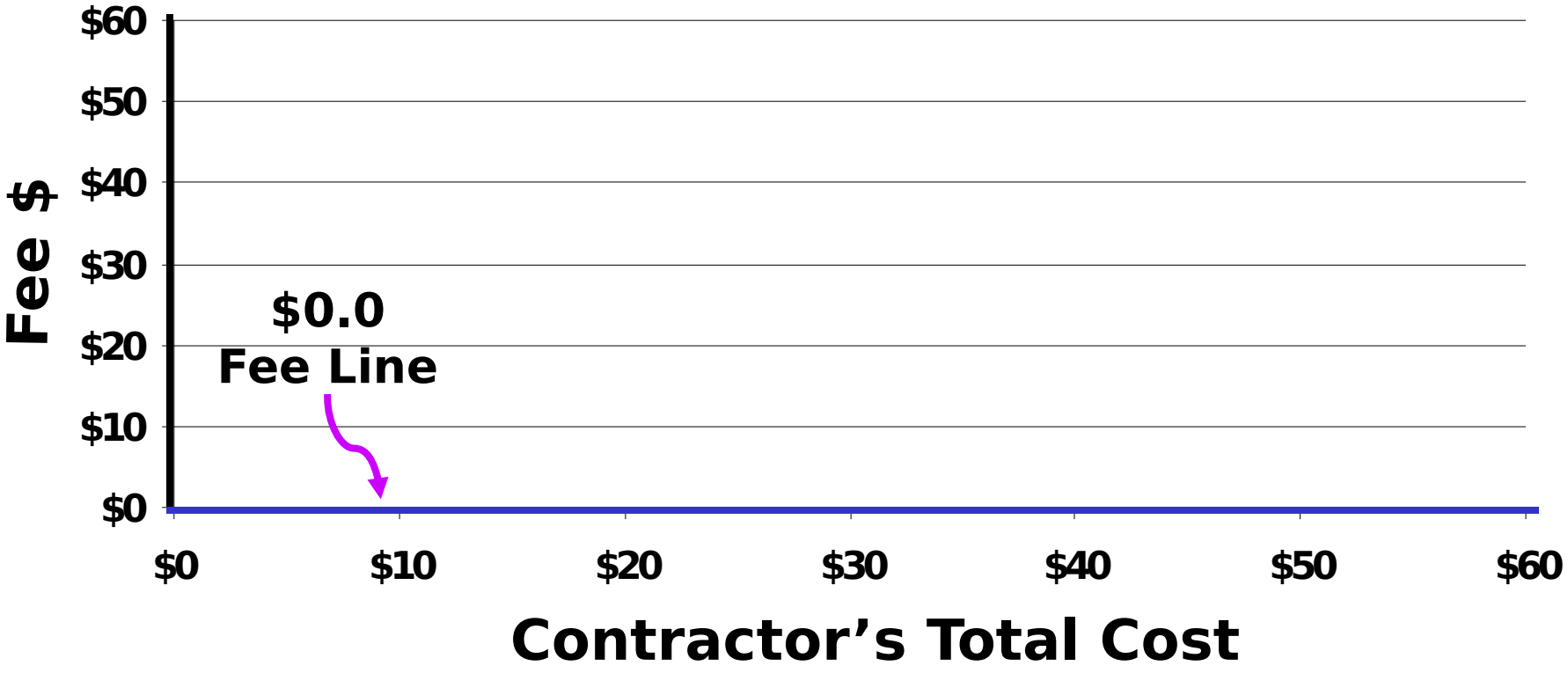
Cost Sharing
Alternative Arrangements

Government reimburses Contractor only for an Agreed
Upon portion of its Allowable Cost

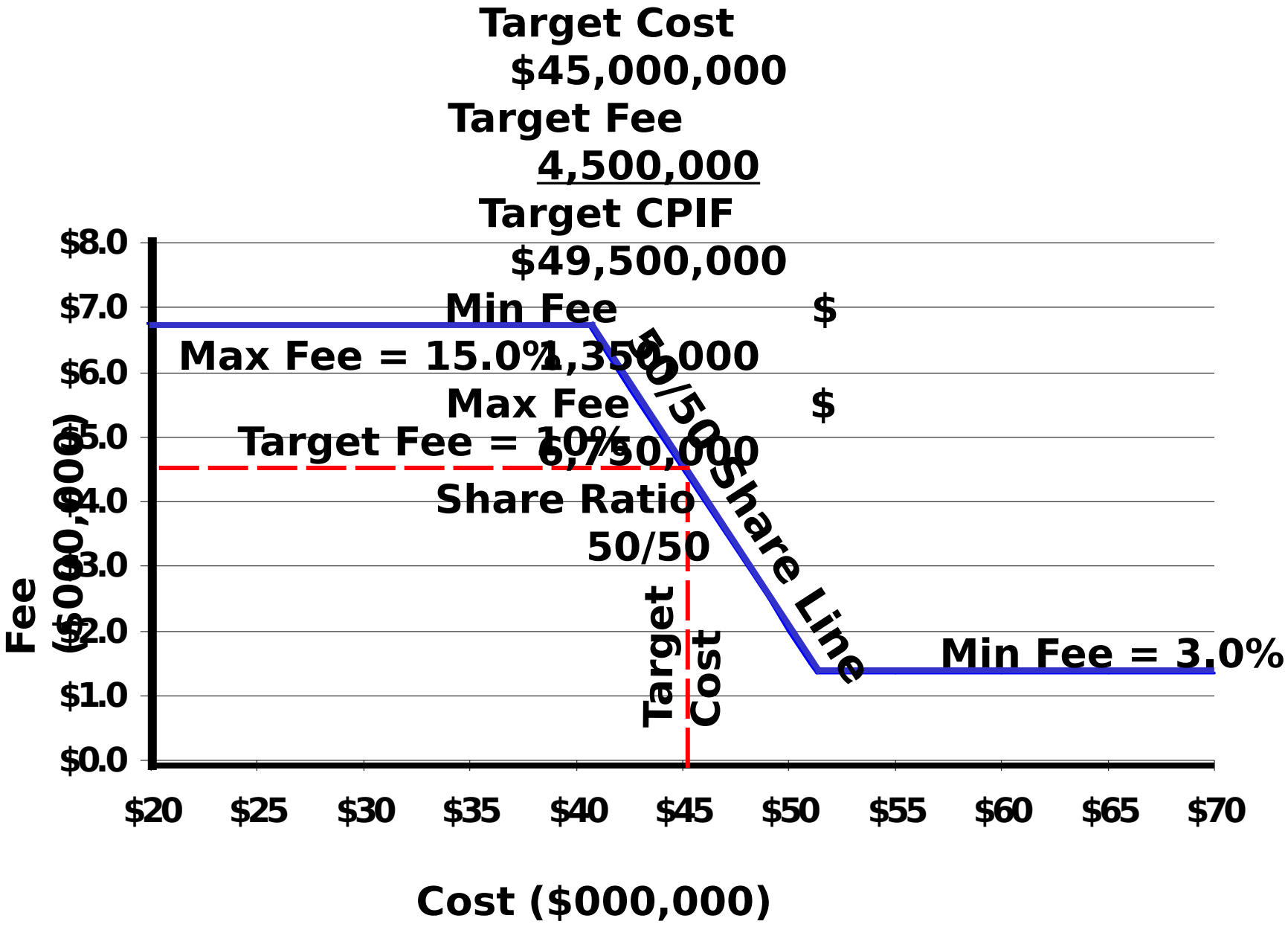


Cost Reimbursement No Fee

Government reimburses Contractor 100.0% of Costs Incurred

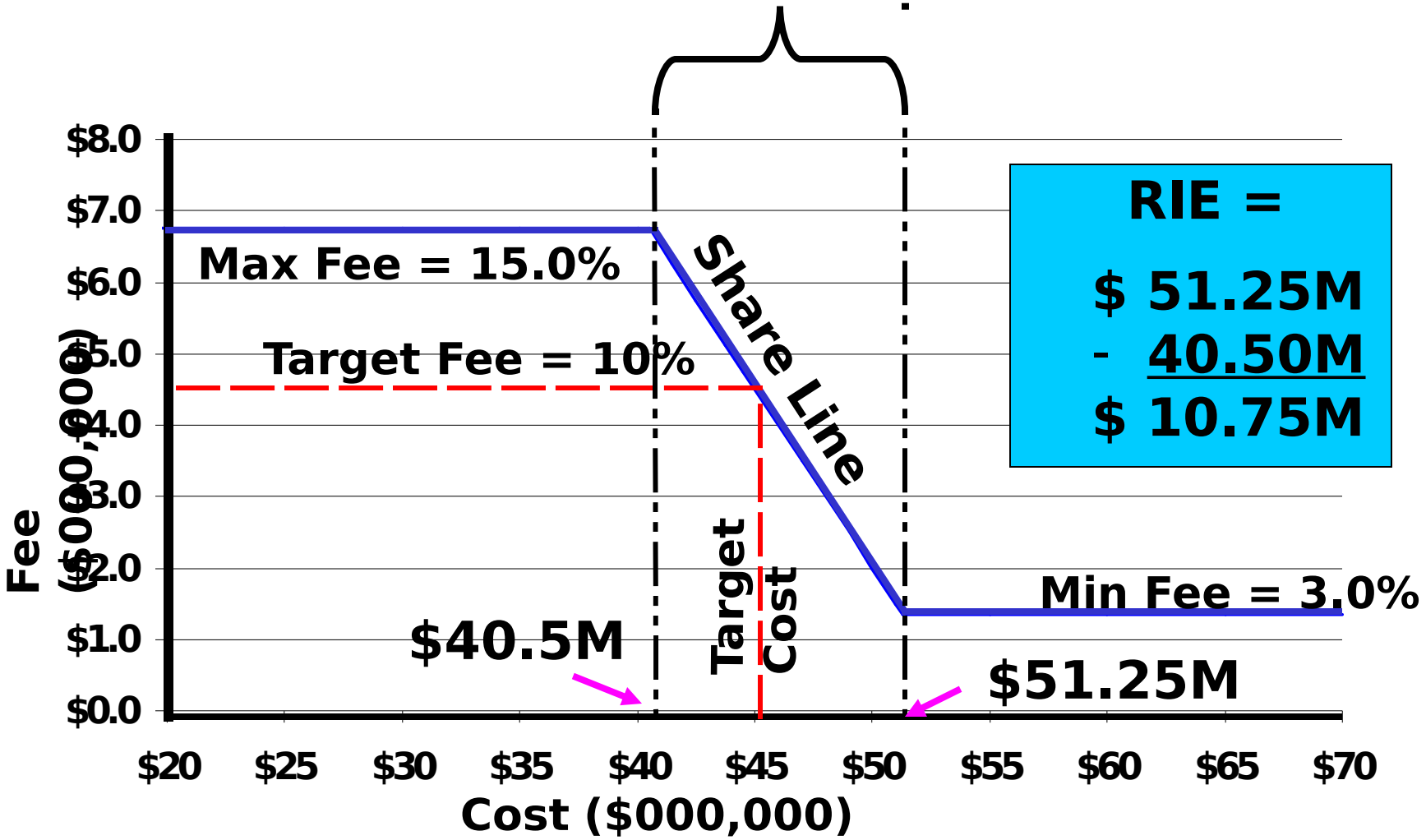


Cost Plus Incentive Fee (CPIF)



Cost Plus Incentive Fee (CPIF)

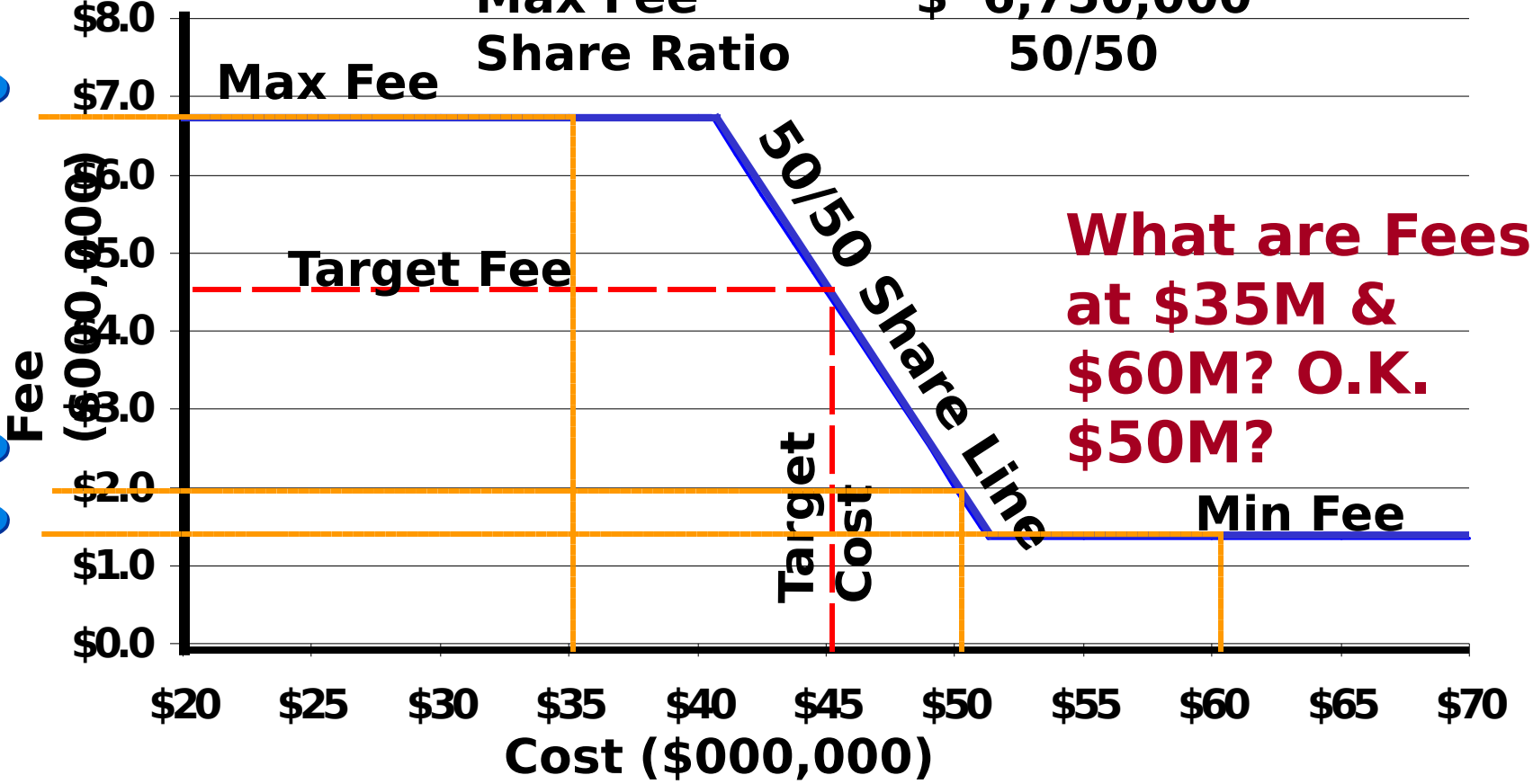
Range of Incentive Effectiveness (RIE)



Cost Plus Incentive Fee (CPIF)

(Millions)

Target Cost	$45,000,000
Target Fee	4,500,000
Target CPIF	$49,500,000
Min Fee	$ 1,350,000
Max Fee	$ 6,750,000
Share Ratio	50/50



What are Fees at $35M & $60M? O.K. $50M?

Cost Plus Incentive Fee (CPIF)

(Millions)	
Target Cost	$45,000,000
Target Fee	4,500,000
Target CPIF	$49,500,000
Min Fee	$ 1,350,000
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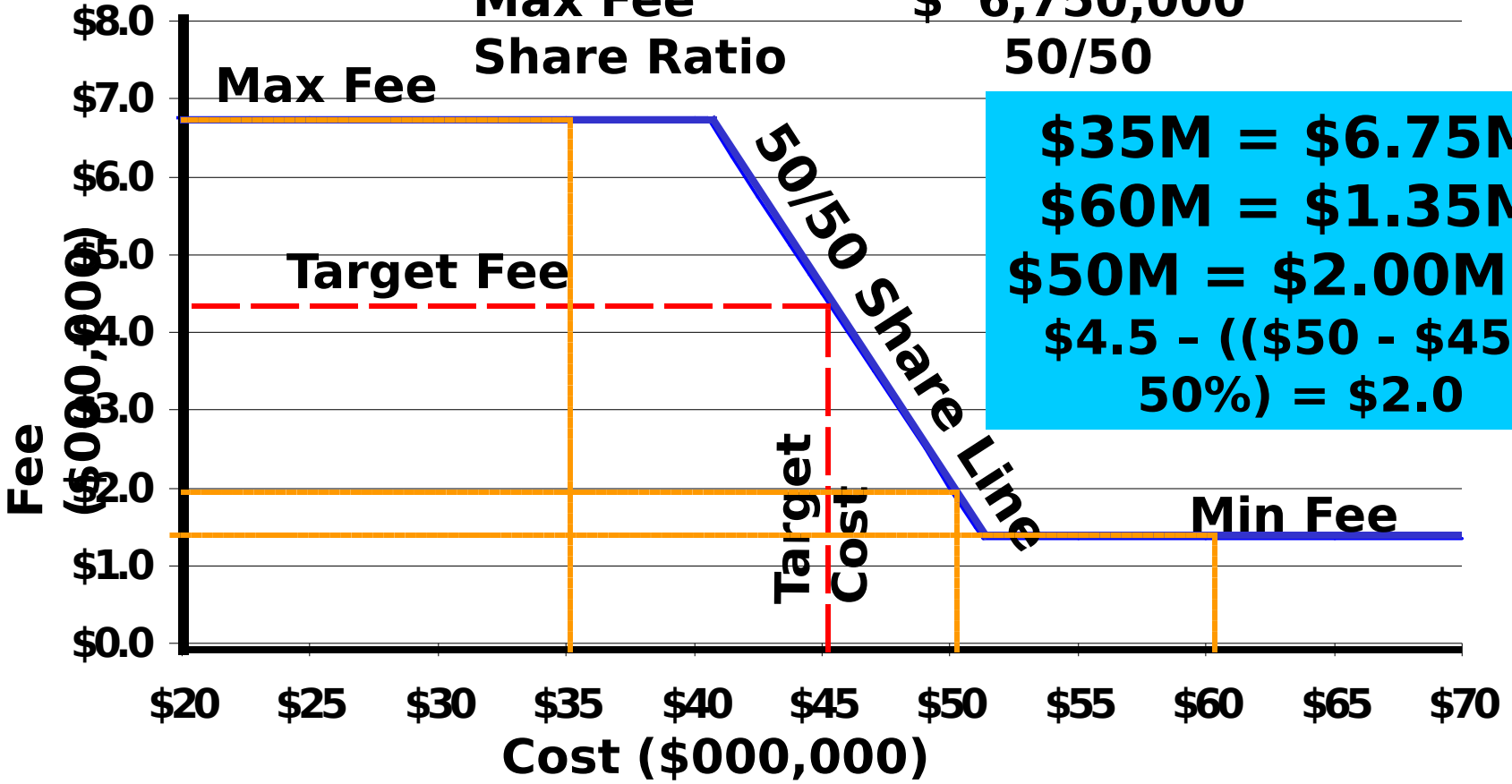
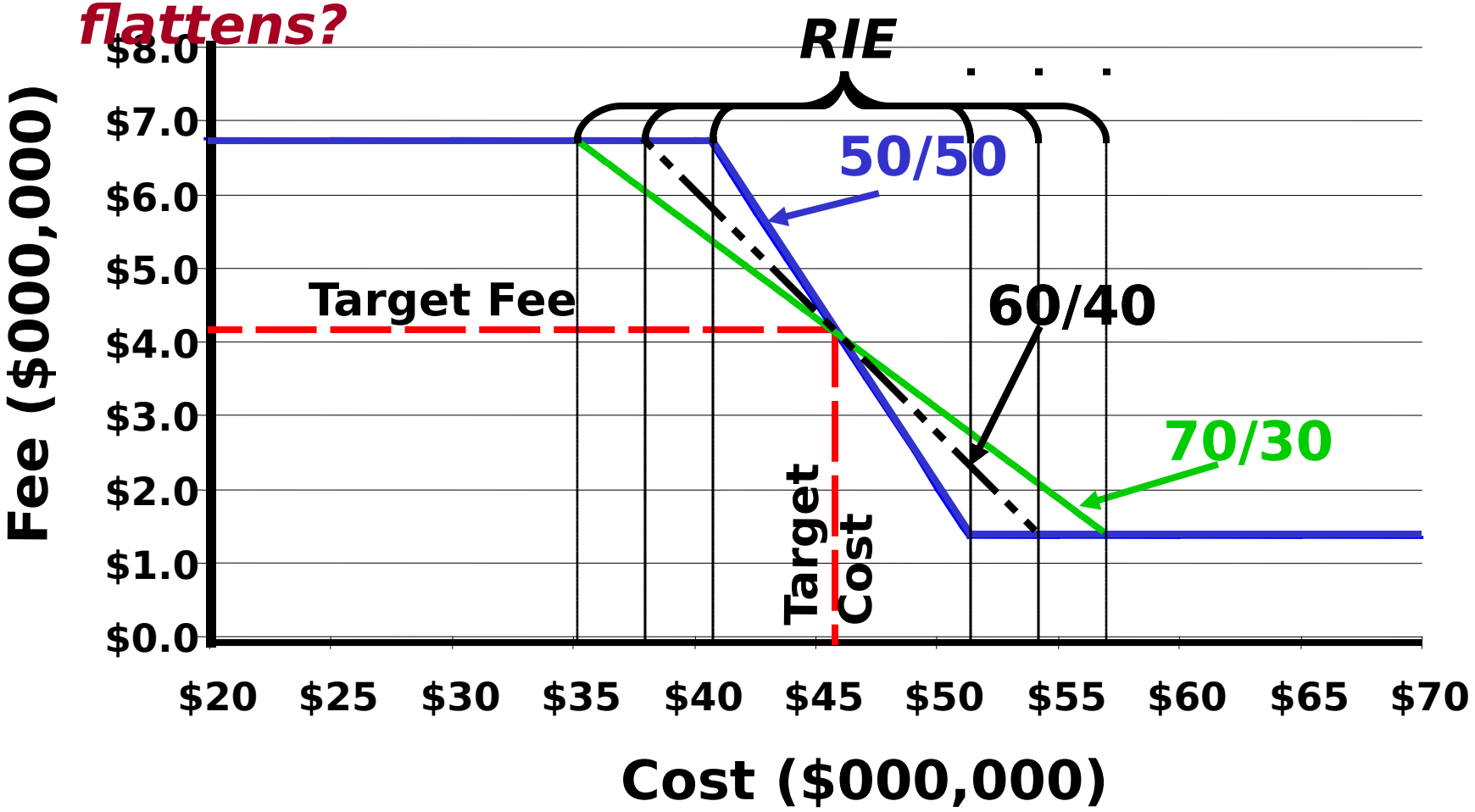


$35M = $6.75M;
$60M = $1.35M;
$50M = $2.00M or
$4.5 – (($50 - $45)* 50%) = $2.0

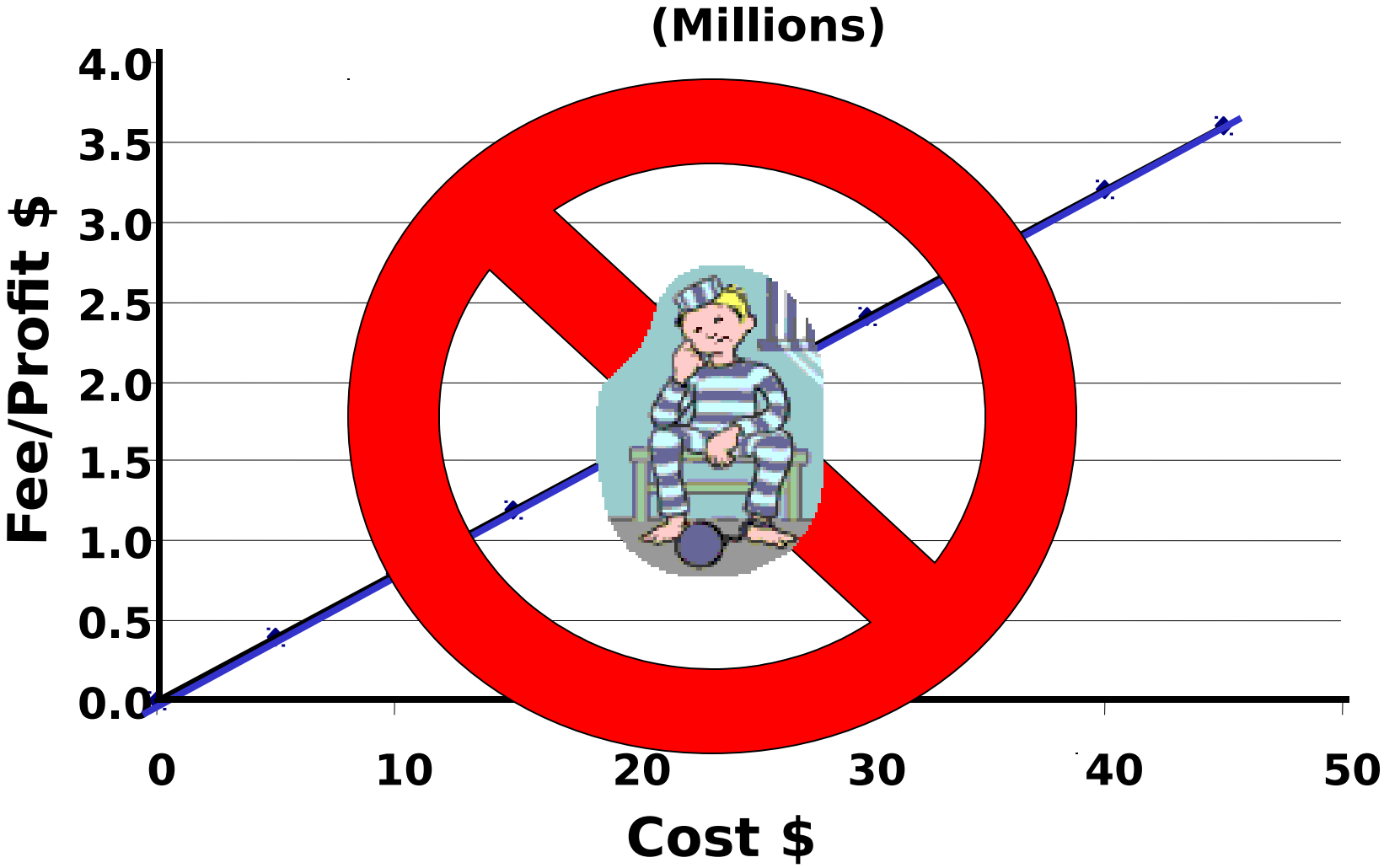
Cost Plus Incentive Fee (CPIF)

How do Fee outcomes vary at <u>Unique</u> Share Ratios?

What happens to RIE as Share Line flattens?



Cost Plus Percentage of Cost



Cost Plus Percentage of Cost (CPPC)

"The purpose of Congress was to protect the Government against
the sort of exploitation so easily accomplished under cost-plus-percentage-of-cost contracts under which the Government contracts and is bound to pay costs, undetermined at the time the contract is made and to be incurred in the future, plus a commission based on a percentage of these future costs" Muschany v United States, 31 Supreme Court

Requirements for CPPC

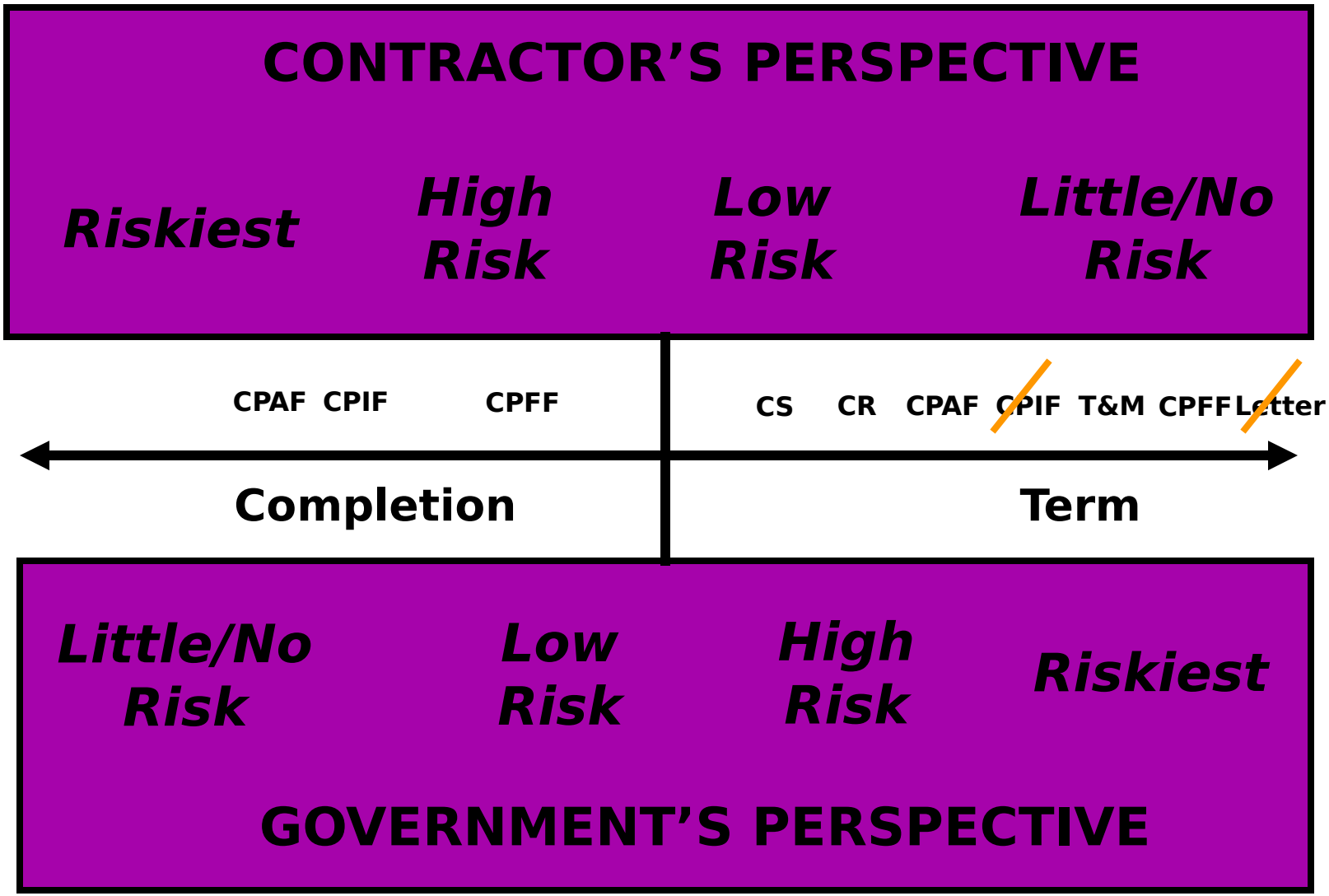
1. Payment is at a pre-determined rate,

2. The pre-determined rate is applied to actual performance costs.

3. The contractor's entitlement is uncertain at the time of contracting and,

4. The contractor's entitlement increases commensurately with increased performance costs.

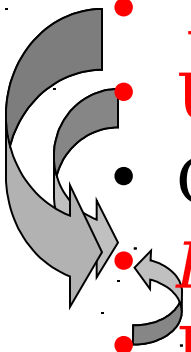
Contract Risk Continuum



Backup

Factors in Selecting Contract Type

FAR 16 and as Supplemented



- Type & Complexity of Requirement
- Urgency of Requirement
- Contractor's Technical & Financial Capability
- *Price/Cost Analysis*
- Period of Performance
- Concurrent Contracts
- Price Competition
- Adequacy of Contractor's Accounting System's
- Extent and Nature of Proposed Subcontracting
- Acquisition History

More Factors

DFARS 216.14-70 Research & Development (R&D)

Contract type must fit the work required, not program c

- **Research and Exploratory Development**
  - **CPAF, CPFF-Term, CR-no fee, Cost Sharing, <$100K FFP-LOE**
- **Advance Development**
  - **CPFF**
  - **CPIF is OK, <u>but</u> must have realistic & measurable targets and achievement is predictable with reasonable degree of accuracy**
    - **<u>DO NOT</u> use CPIF without performance incentives when there's a large number of technical changes or actions beyond contractor's control hinder achievement of Target Cost**
- **Engineering or Operational Systems Development**
  - **Preferred contract type is Cost Reimbursement**
  - **<u>Fixed Price Contract</u> for development > $25M must be approved by USD(AT&L) based on**
    - **Level of program risks permits realistic pricing**
    - **Contract type permits sensible and equitable allocation of program risks between the parties**
  - **PCO must approve and document rationale for fixed price < $25M**